

Buffalo Small Cap Fund

QUARTERLY
COMMENTARY

September 30, 2022

Capital Market Overview

The stock market extended year-to-date losses during the 3rd quarter and has now fallen for three consecutive quarters. The S&P 500 Index retreated by -4.88% from July 1st to September 30th bringing the YTD total return to -23.87%, which is bear market territory. Stubbornly-high inflation, aggressive interest rate increases, rising fear of a recession, and expectations for softer corporate earnings in the upcoming reporting period were the main headwinds. The Federal Reserve's hawkish stance on inflation resulted in two more oversized federal funds rate hikes during the quarter, bringing the target rate to 3.00%-3.25%. Federal Reserve officials also signaled for additional rate hikes moving forward and holding higher rates for as long as necessary to curb inflation, even if it leads to economic pain. Short-term Treasury yields (two-year notes) are higher than long-term yields (10-year notes) and the yield curve is now inverted by the most since 2000, an indication of a potential recession.

The broad-based Russell 3000 Index declined -4.46% in the quarter and has fallen -24.62% year-to-date. Value stocks fell more than growth stocks during the quarter as the Russell 3000 Value Index returned -5.56% versus a return of -3.37% for the Russell 3000 Growth Index. Relative performance improved going down in market cap size as small caps declined less than large caps in the quarter. Larger cap stocks, as measured by the Russell 1000 Index, returned -4.61% compared to the smaller cap Russell 2000 Index return of -2.19% and the Russell Microcap Index return of -0.48%.

Performance Commentary

A rebound in deeply oversold Health Care stocks led the Russell 2000 Growth to modest gains for the quarter. It was a difficult period for small cap active managers as profitless companies, many in biotechnology, were the best performers during the quarter. Biotechnology and Pharmaceuticals were two of the better performing, large-weighted industries gaining 10.07% and 14.78% respectively, and comprising over 11.5% of the Russell 2000 Growth Index.

Despite this difficult backdrop, the Buffalo Small Cap Fund (BUF SX) produced a return of 3.53% for the quarter, outperforming the Russell 2000 Growth's return of 0.24%. Outperformance in Technology, Industrials, and Financials offset relative underperformance in Health Care and Consumer Discretionary. While the index returns in Biotechnology and Pharmaceuticals were strong headwinds to relative performance in Health Care, the Fund's holdings in Medical Equipment and Health Care Services stocks nearly offset their advance. In Technology, strength in Communications Equipment and IT Services overcame weakness in Software. Industrials gained due to strength in Building Products, Solar stocks, and Professional Services.

Average Annualized Performance (%)

As of 9/30/22	1 YR	3 YR	5 YR	10 YR	15 YR	Since Inception
Investor Class - BUF SX	-31.85	11.57	11.12	11.19	8.45	11.44
Institutional Class - BUISX ¹	-31.72	11.73	11.30	11.36	8.61	11.60
Russell 2000 Growth Index	-29.27	2.94	3.60	8.81	6.82	5.52
Morningstar U.S. Small Growth Index	-34.89	0.53	3.35	8.24	6.49	-
Lipper Small Cap Growth Fund Index	-28.70	5.05	7.29	9.91	7.04	6.72

¹For performance prior to 7/1/19 (Inception Date of Institutional Class), performance of the Investor Class shares is used and includes expenses not applicable and lower than those of Institutional Class shares. Data represented reflects past performance and is no guarantee of future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original value. Current performance may be lower or higher than the performance quoted. Performance current to the most recent month end may be obtained by visiting the Funds' website at buffalofunds.com.

Fund Facts

	Investor	Institutional
Ticker:	BUF SX	BUISX
Inception Date:	4/14/98	7/1/19
Expense Ratio:	1.01%	0.86%
Fund Assets:	\$807.40 Million	
Category:	Small Cap Growth	
Benchmark:	Russell 2000 Growth Index	

Management Team



Jamie Cuellar, CFA

Co-Manager since 2015
M.B.A. – Southern Methodist
B.B.A. – Univ. of San Diego



Bob Male, CFA

Manager since Inception
M.B.A. – Southern Methodist
B.S. – University of Kansas



↑ Top Contributors

Calix was the greatest contributor to performance during the quarter. After considerable outperformance in 2021, the stock sold off in the first half of 2022 despite stable fundamentals. The Fund increased its position on the pullback and was rewarded with the stock gaining almost 80% this quarter, as the company continued to see strong demand for its broadband communications systems and software for smaller broadband service provider customers. The company has managed a difficult supply chain environment exceptionally well and has successfully transformed its business into a higher margin platform company from a legacy hardware company.

TransMedics was again one of the top contributors for the Fund during the period. The company's innovative Organ Containment System ("OCS") and National OCS Program ("NOP") continued to see rapid uptake translating to accelerating revenue growth of over 150% in the 2nd quarter, as reported in early August. Despite the very weak capital markets environment this year, the company was able to raise over \$100 million in an upsized public offering, further bolstering their balance sheet.

↓ Top Detractors

Codexis was the largest detractor for the Fund this quarter as a surprise reduction in financial guidance in July sent the stock lower. Codexis saw decreased demand for its enzymes from Pfizer used in the production of Paxlovid, a treatment for COVID-19. Additionally, the weak capital markets backdrop and a reduced funding environment delayed additional projects by smaller customers. We believe Codexis technology remains sound and recent management changes should benefit the company.

Outlook

As discussed in our outlook coming out of the 2nd quarter, we believe small cap stocks have already rerated for a considerable slowdown in economic growth. While the asset class enjoyed a nice rally in the first half of the 3rd quarter, it was not sustained, and small caps ended the quarter about where they started. We continue to believe a lot of the bad news has been priced in, but markets will remain volatile. We believe the direction of the market will continue to depend on inflation's trajectory, how aggressive the Federal Reserve must be to rein in inflation, and the amount of economic damage caused by higher interest rates.

The inflation picture continues to ebb and flow. While we are seeing a decline in logistics costs, shipping rates, and some commodity prices, component shortages continue to persist. Generally, it seems price increases are moderating but the sustainability of this moderation is questionable. While the Fed has already increased interest rates by 300 basis points, market expectations forecast another 100 to 125 basis point increase in this tightening cycle. In response, there has been a growing chorus for the Fed to slow its pace of tightening and allow previous hikes to make their way through the economy. Meanwhile, global economies continue to slow, especially in Europe where energy prices remain high. While many companies have already lowered financial guidance for the year, we could be in store for another earnings season of decreasing estimates which may possibly bring more market volatility.

At the portfolio level, we are taking advantage of market volatility by increasing positions in stocks that are oversold and trimming those that are fully valued or have exceeded our market capitalization guidelines. We are being cautious with unfamiliar management teams and their ability to navigate a less predictable economy and market volatility. Portfolio turnover has remained consistent with prior years, or even a touch lower year-to-date. New positions have been made in a few ideas we've owned previously such as Natera and Kornit Digital, which are currently trading at much more attractive valuation levels.

Despite trimming some winners in Health Care, we remain overweight the sector as these companies are generally less sensitive to a slowing economy. Portfolio positioning is fairly defensive within Technology with a focus on a steadier IT Services industry and the Communications Equipment industry which has unique demand drivers due to government subsidies. On the other hand, the portfolio is underweight Semiconductors and Software relative to the benchmark. A few higher quality energy-related stocks corrected meaningfully in the 3rd quarter which allowed us to increase energy sector exposure at more favorable risk/reward although the portfolio remains underweight relative to the benchmark. Larger positions within the portfolio continue to be companies with recurring revenue streams or those with strong demand and good visibility into future earnings.

As always, all holdings benefit from long-term growth trends and trade at attractive valuations - the cornerstone of our investment process. We thank you for your continued support. ▲

Interested in more info?

For questions or to speak with a relationship manager about adding any of the 10 Buffalo Funds to your portfolio, contact:

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The Fund's investment objectives, risks, charges, and expenses must be considered carefully before investing. The summary and statutory prospectuses contain this and other important information about the investment company and can be obtained by calling (800) 49-BUFFALO or visiting buffalofunds.com. Read carefully before investing.

Earnings growth is not representative of the Fund's future performance.

As of 6/30/22 the Buffalo Small Cap Fund top 10 equity holdings were ICF Intl 3.12%, Privia Health Group 2.81%, Halozyme Therapeutics 2.55%, MGP Ingredients 2.39%, Palomar Holdings 2.32%, NV5 Global 2.30%, Evolent Health 2.13%, TransMedics Group 2.08%, Everi Holdings 2.05%, Calix 2.05%. Top 10 holdings for the quarter are not disclosed until 60 days after quarter end.

The opinions expressed are those of the Portfolio Managers and are subject to change, are not guaranteed, and should not be considered recommendations to buy or sell any security. Fund holdings and sector allocations are subject to change and are not recommendations to buy or sell any security.

The S&P 500 Index is a capitalization weighted index of 500 large capitalization stocks which is designed to measure broad domestic securities markets. The Russell 3000 Index measures the performance of the 3,000 largest publicly held companies incorporated in the U.S. based on market capitalization. The Russell 3000 Value Index is based on the Russell 3000 Index, of companies with lower price-to-book ratios and lower expected growth rates which measures how U.S. stocks in the equity value segment perform. The Russell 3000 Growth Index is a market-capitalization weighted index that measures the performance of those Russell 3000 Index companies with higher price-to-book ratios and higher forecasted growth rates. The Russell 1000 Index is a subset of the Russell 3000 Index and measures the performance of the 1,000 largest publicly-held companies incorporated in the U.S. based on market capitalization. The Russell 2000 Index is an unmanaged index that consists of the smallest 2,000 securities in the Russell 3000 Index, representing approximately 10% of the Russell 3000 total market capitalization. The Russell Microcap Index is a n unmanaged capitalization weighted index of 2,000 small cap and micro cap companies. The Russell Midcap Index measures performance of the 800 smallest companies in the Russell 1000 Index. The Morningstar U.S. Small Growth Index measures the performance of U.S. small-cap stocks that are expected to grow at a faster pace than the rest of the market as measured by forward earnings, historical earnings, book value, cash flow and sales. The Lipper Small Cap Growth Fund Index is an unmanaged, equally weighted performance index of the 30 largest qualifying mutual funds (based on net assets) in the Lipper Small-Cap classification. One cannot invest directly in an index. A basis point (bps) is one hundredth of a percentage point (0.01%).

Mutual fund investing involves risk. Principal loss is possible. The Fund invests in smaller companies, which involves additional risks such as limited liquidity and greater volatility than larger companies. Investments in foreign securities involve greater volatility and political, economic and currency risks and differences in accounting methods. This risk is greater in emerging markets.

Kornitzer Capital Management is the advisor to the Buffalo Funds, which are distributed by Quasar Distributors, LLC.

